(19)

No. 92-1384

In The
Supreme Court of the United States
October Term, 1993

Barclays Bank PLC,
Petitioner,
v.

Franchise Tax Board,
An Agency of the State of California,
Respondent.

On Writ of Certiorari to the Court of Appeal of the State of California in and for the Third Appellate District

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BRIEF OF THE FEDERATION OF GERMAN INDUSTRIES AND THE ASSOCIATION OF GERMAN CHAMBERS OF INDUSTRY AND COMMERCE AS AMICI CURIAE SUPPORTING PETITIONER

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QUESTIONS PRESENTED

1. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional under the Foreign Commerce Clause of the United States Constitution.

2. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, is unconstitutional where such application imposes discriminatory compliance burdens on such entities.

3. Whether California's application of worldwide combined reporting to determine the taxable income of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, intrudes into an inherently federal area and is preempted by the United States Constitution.

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INTEREST OF AMICI CURIAE

The Federation of German Industries (Bundesverband der Deutschen Industrie) (herein "BDI") is composed of 34 member organizations, for example, the Confederation of Chemical Industry, and represents virtually all the manufacturing enterprises' associations in Germany. The Association of German Chambers of Industry and Commerce (Deutscher Industrie- and Handelstag) (herein "DIHT") is made up of 85 local Chambers of Industry and Commerce, which represent about 2,800,000 indus-

trial and trade enterprises. Since membership in DIHT is mandatory, virtually all German companies are included.

The purpose of BDI and DIHT is to represent German businesses and their interests on a national and international level. Practically all major German industrial companies having well-recognized trade names in the United States, such as Bayer, BASF, Volkswagen, BMW, Mercedes-Benz, and Siemens, for example, belong to BDI and DIHT. Thus, both are concerned by, and opposed to, Respondent's reliance upon the method of corporate income allocation known as worldwide combined reporting ("WWCR").

The Council submits this brief *amici curiae* in support of Petitioner.[1]

SUMMARY OF ARGUMENT

No country uses WWCR. The foreign policy of the United States in taxation of international corporate income is in agreement with international principles of corporate taxation: WWCR is not accepted. That policy is embodied in United States treaty and statutory provisions, as well as clearly and consistently expressed by the Federal Government.[2]

The use of WWCR to include overseas income and factors in California's taxation of domestic corporations with foreign parents, or foreign corporations with either foreign parents or foreign subsidiaries, clearly prevents the United States from speaking with one voice in matters of

[1] Petitioner and Respondent have consented to the filing of this brief *amici curiae* in letters filed with the Clerk of this Court.

[2] See, for example: The Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes, with a related Protocol, exchange of notes and memorandum of understanding. Signed at Bonn, August 29, 1989; Brief For the United States as Amicus Curiae submitted herein, p. 3, n.2; and Pet. App. H10 for a complete list of U.S. income tax treaties.

foreign commerce: foreign policy issues which must be left to the Federal Government are implicated, thereby violating the Foreign Commerce Clause of the United States Constitution.[3]

ARGUMENT

I. THE APPLICATION OF WORLDWIDE COMBINED REPORTING TO FOREIGN CORPORATIONS AND DOMESTIC SUBSIDIARIES OF FOREIGN CORPORATIONS IS AT VARIANCE WITH THE UNITED STATES FEDERAL GOVERNMENT'S POLICY OF INTERNATIONAL CORPORATE TAXATION.

The United States Federal Government's international tax policy is embodied in the Internal Revenue Code provisions for the income taxation of foreign corporations and in all the double taxation treaties of which the U.S. is a signatory.[4] This policy provides a coherent allocation system for eliminating double taxation of multinational corporate groups. These statutory and treaty provisions embody the "voice" of the Federal Government in the vital area of international commercial relations. This voice establishes separate accounting among affiliated corporations based upon the arm's length principle as the coherent federal policy under which income is allocated between the U.S. and foreign countries.

The arm's length principle is based upon the economic concept of market pricing, the foundation of the free world economic system. It says, in effect, that if one business within an international corporate group sells to another within the same group, but operates within a different taxing jurisdiction, the profits attributable to the taxing jurisdictions shall be the profits expected to be made in those jurisdictions if they were separate and independent businesses engaged in the same or similar activities under

[3] U.S. Const., art. 1, § 8, cl. 3.

[4] At present there are forty such treaties ratified and in effect. The express purpose of these treaties is the avoidance of international double taxation.

the same or similar conditions and dealing wholly independently with each other.

Respondents rejects international corporate taxation principles when it uses WWCR. Separate entities—foreign and domestic—making up a multinational corporate group are treated as one. Their combined income is apportioned between California and the rest of the world on the basis of an arbitrary formula of the ratio of payroll, sales, and property of the entire corporate group in California compared to the world. No regard is given to whether such income is taxable under the Internal Revenue Code or applicable treaty, nor to the fact that income has been attributed to and taxed in foreign jurisdictions in accordance with international law.

II. THE APPLICATION OF WORLDWIDE COMBINED REPORTING TO FOREIGN CORPORATIONS AND DOMESTIC SUBSIDIARIES OF FOREIGN CORPORATIONS PREVENTS THE UNITED STATES FROM SPEAKING WITH ONE VOICE WHEN REGULATING COMMERCIAL RELATIONS WITH FOREIGN GOVERNMENTS.

This Court has set forth straightforward tests for judging the constitutionality of a state tax. In *Japan Line, Ltd. v. County of Los Angles,* two additional tests, other than those used in assessing constitutionality under the interstate commerce clause, were described, the contravention of either of which would render a state tax unconstitutional:

> first, whether the tax creates a substantial risk of international multiple taxation; and second, whether the tax prevents the Federal Government from speaking with one voice when regulating commercial relations with foreign governments.[5]

In *Container Corp. of America v. Franchise Tax Board,* this Court explained that a state tax:

[5] 441 U.S. at 451 (1979).

> at variance with federal policy will violate the "one voice" standard if it *either* implicates foreign policy issues which must be left to the Federal Government *or* violates a clear federal directive . . .;

and specified that:

> The most obvious foreign policy implication of a state tax is the threat it might pose of offending our foreign trading partners and leading them to retaliate against the nation as a whole.[6]

The use of WWCR clearly meets those tests. The twelve Member States of the European Communities: Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, and the United Kingdom; and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland have repeatedly expressed their formal objections to Respondent's use of WWCR as:

> (1) contradictory to, and incompatible with, accepted international principles of corporate tax assessment and the purpose of double taxation and/or friendship, commerce and navigation treaties to which the United States is a party;
>
> (2) an impediment to investment and trade with the U.S.[7]

Even retaliation, the "most obvious foreign policy implication of a state tax," [8] has materialized. Section 54 of and Schedule 13 to the Finance Act of 1985 (now reenacted as Section 812-815 of the Income and Corporations Taxes Act 1988) gives the United Kingdom power to retaliate for the use of WWCR by withdrawing from

[6] 463 U.S. at 194 (1983).

[7] See Brief of the Member States of the European Communities and the Governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland as Amici Curiae Supporting Petitioner, (April 22, 1993).

[8] 463 U.S. at 194.

American corporations incorporated in California or having their principal place of business there, the right to claim shareholders' tax credit in respect of dividends paid to them by their United Kingdom subsidiaries.

III. THE APPLICATION OF WORLDWIDE COMBINED REPORTING TO FOREIGN CORPORATIONS AND DOMESTIC SUBSIDIARIES OF FOREIGN CORPORATIONS IS DIFFERENT FROM ITS APPLICATION TO DOMESTIC PARENT CORPORATIONS WITH FOREIGN SUBSIDIARIES.

The use of WWCR to include the worldwide income of foreign corporations doing business in the United States and of their domestic subsidiaries is fundamentally different from the situation involving domestic parent corporations with foreign subsidiaries. The United States Federal Government taxes the income of domestic multinational corporate groups. subject to the provisions of the Internal Revenue Code, including tax credits, tax deferrals, and .various other sections designed to alleviate double taxation. This broad jurisdiction does not exist with regard to foreign corporations or foreign parent corporations with domestic subsidiaries. The only income from their operations subject to the U.S. taxing jurisdiction is income with a geographical source in the U.S., i.e., the U.S. portion of a foriegn corporation's income, or the income of its domestic subsidiary. As seen above, the U.S. approach of exercising its tax jurisdiction on a residence or source of income basis is generally consistent with international practice.

When WWCR is applied to U.S. parent corporations with foreign subsidiaries, income attributable to those foreign subsidiaries is included in calculating the taxable income of the domestic corporation. The legal incidence of the tax falls on a domestic corporation. However, as in this case, when WWCR is applied to a foreign corporation, with U.S. income and a U.S. subsidiary, a foreign corporation's income is directly impacted. It is that in-

come, and the income of the foreign corporation's foreign subsidiaries, earned and taxed by foreign governments under separate accounting principles, that California is also taxing.

The discriminatory effect of the burden to comply with the reporting requirements of WWCR is also more obvious in the case of a foreign parent corporation. WWCR requires corporate taxpayers to provide details of taxable income for worldwide operations translated into English and adjusted to U.S. and even specific state taxation accounting principles and U.S. currency. An American parent corporation is at least familiar with the United States and States' taxing accounting concepts and unitary principles, however costly it may be to comply. A foreign parent is not familiar with those concepts and principles, making compliance much more burdensome. Foreign parent corporations in a number of countries already have to provide details of taxable income of worldwide operations translated and adjusted to the accounting principles and currency of their country of residence. If they also have to provide similar information about the group as a whole in all countries in which a member of the group operates, that puts a disproportionate burden on international business.

The relationships between domestic and foreign-based corporate groups and their subsidiaries are also distinct. WWCR requires the income and activities of a foreign parent corporate group to be taken into account solely on the basis of activities which it attributes to the United States, when most often neither the foreign parent nor other subsidiaries conduct any business in the U.S. While it may be argued that domestic parent corporations exercise control over their foreign subsidiaries, thereby making the income and activities of the domestic parent group susceptible to attribution to the U.S., it is plain that domestic subsidiaries of foreign parent corporations do not control their foreign parents. Thus, the attribution by

WWCR of foreign income of foriegn parents and their foreign subsidiaries is clearly inappropriate.

CONCLUSION

Respondents' use of WWCR is patently inconsistent with United States policy. It prevents the United States Federal Government from speaking with one voice in a field that must be left to it. The implication of United States foreign policy by WWCR is a matter of international record. Its application to foreign corporations and foreign corporations with U.S. subsidiaries is clearly unconstitutional: an obvious violation of the Foreign Commerce Clause of the United States Constitution.

The Federation of German Industries and The Association of German Chambers of Industry and Commerce respectfully ask this Court to reverse the decision of the California Supreme Court.

Respectfully submitted,

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